Question
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YOUR MONEY

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Examining mutual funds to maximize performance

Not all investments are created equal

Mutual funds can be a great way of diversifying holdings and achieving investment goals. However, not all mutual funds are created equal. Taking a moment to examine the facts and ensure your holdings are up to par can be well worth the effort.

The first area to examine is to look at the initial set-up of your mutual funds. A common way of purchasing mutual funds is through a DSC or BE set-up (Deferred Sales Charge or Back-End load) where up-front commissions are waived if the funds are held for a set period of time, usually six to seven years. Unfortunately, if you need to sell prior to the maturity date, you could be charged anywhere from 3-6% in redemption fees. If you invested $20,000 in a DSC fund, it could cost you anywhere from $600 to $1,200 in redemption fees to get out and it makes no difference if the fund is underperforming.

If you own underperforming DSC funds, you have some options. You can take advantage of the yearly 10% redemption allowance or you can switch within the fund family to a better performing product. Neither option is perfect but at least they can help minimize DSC exposure and return some of your flexibility.

Your depth of diversification is an important aspect to examine. The average mutual fund investor only needs 5-6 solid funds to achieve adequate diversification. Any more and you start to see the holdings overlap because many funds have the same companies in their top holdings. For example, if you have several types of Canadian-focused funds, chances are very good that you own a fair bit of Royal Bank.

A red flag should go up if your funds are primarily in-house products. If you are at XYZ firm and invested only in XYZ's proprietary products, you want to know the reason for the bias. Your advisor should not be under pressure or obligation to recommend specific products but should be free to match your financial goals with the best funds in the marketplace.

And finally, management expense ratios (MER) merit very careful examination. In addition to whatever initial set-up fees you are charged, you are subject to ongoing MERs. If they are unjustly high, MERs can severely reduce your nest egg.

MERs are a fact of life in the mutual fund world, but there are ways to reduce them. If your funds have been underperforming too long and are subject to high MERs, think about switching. Search for funds with solid track records whose MERs are more in line with the fund's performance.

You can also reduce the amount of money you are paying in MERs by getting rid of unnecessary funds. For example, if you hold a money market mutual fund, you are likely better served by a no-fee high interest savings account. Chances are that you'll make similar returns, but without paying fees.

The goal of any well-managed portfolio is to achieve better returns with less risk. If yours hasn't been performing to expectations, it may be time to ensure your current allocation is still in sync with your original goals. The time invested in a close examination might be the best investment you can make.

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